

Message Text

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C O N F I D E N T I A L EC BRUSSELS 0053

E.O.11652: GDS
TAGS: EFIN EEC IT
SUBJECT: EC COMMISSION COMMENTS ON COMMUNITY LOAN AND PROPOSED
1977 GUIDELINES FOR ITALY

REF: (A) 76 EC BRUSSELS 11752 (B) 76 EC BRUSSELS 12360
(C) 76 EC BRUSSELS A-558

1. SUMMARY: EC OFFICIALS HAVE COMMENTED IN CONFIDENCE ON PROPOSED 1977 COMMUNITY GUIDELINES FOR ITALY AND PROSPECTS FOR FINAL APPROVAL OF THE COMMUNITY LOAN FOR ITALY. THESE GUIDELINES, PROPOSED BY THE ITALIAN AUTHORITIES DURING THE RECENT VISIT OF THE COMMISSION TEAM TO ROME (REF A), WERE SUMMARIZED IN REF B, AND SPELLED OUT IN DOCUMENT ATTACHED TO REF C. THE COMMISSION HAS SOME SIGNIFICANT DIFFERENCES WITH THE ITALIAN PROPOSALS, BUT EXPECTS AGREEMENT ON THE GUIDELINES AND FINAL APPROVAL OF THE LOAN THIS MONTH OR NEXT. END SUMMARY.

2. IN THEIR MAJOR DIFFERENCE WITH ITALIAN AUTHORITIES COMMISSION OFFICIALS FEEL THE PROPOSED LIMIT ON EXPANSION IN TOTAL LENDING IS MUCH TOO HIGH. THE COMMISSION TEAM IN ROME PUT FORWARD A MUCH LOWER FIGURE (WHICH WE INFER
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TO BE AROUND 6 PERCENT), WHICH OFFICIALS FEEL WOULD BE MORE APPROPRIATE THAN THE ITALIAN PROPOSAL OF 15.3 PERCENT. THE ITALIAN PROPOSAL ASSUMES AN OBJECTIVE OF A 15 PERCENT INCREASE IN CONSUMER PRICES DURING 1977 (DECEMBER TO DECEMBER), AND ZERO REAL GROWTH. (THIS WOULD IMPLY A 20 PERCENT INCREASE IN PRICES ON AN ANNUAL AVERAGE BASIS.) THE COMMISSION STAFF NOT ONLY FEELS

THAT SUCH A PRICE OBJECTIVE IS TOO HIGH, BUT THAT THE CREDIT EXPANSION CEILING SHOULD BE PUT CONSIDERABLY BELOW THE EXPECTED INCREASE IN NOMINAL EXPENDITURE IF IT IS TO HAVE ANTI-INFLATIONARY BITE.

3. THE ITALIAN PROPOSED CEILING ON CENTRAL GOVERNMENT EXPENDITURE (AMOUNTING TO A 19 PERCENT INCREASE ON AN ADJUSTED BASIS) IS ALSO CRITICIZED ALONG THE SAME LINES, ALTHOUGH THE SIZE OF THE DIFFERENCE BETWEEN THE COMMISSION AND THE ITALIAN AUTHORITIES IS SAID TO BE CONSIDERABLY SMALLER. THE PROPOSED LIMITS ON THE TREASURY DEFICIT AND ON THE FINANCING OF THE DEFICIT BY THE MONETARY AUTHORITIES ARE ACCEPTABLE, BUT STRONG DOUBTS ARE EXPRESSED HERE AS TO WHETHER THEY CAN BE ATTAINED ON PRESENT POLICIES. IT IS FELT THAT ITALIAN AUTHORITIES HAVE PROBABLY USED OVER-OPTIMISTIC REVENUE PROJECTIONS IN THEIR ESTIMATE OF THE 1977 TREASURY DEFICIT. ALSO, THE AMOUNT OF THE DEFICIT TO BE FINANCED BY THE MONETARY AUTHORITIES IS SEEN AS NOT FULLY CONTROLLABLE, AS DEMONSTRATED BY THE LARGE OVER-RUN OF THE 1976 CEILING.

4. SOURCES HERE FEEL THAT THE ITALIAN AUTHORITIES WILL FINALLY AGREE TO A 1977 CREDIT EXPANSION CEILING WELL BELOW THEIR ORIGINAL PROPOSAL, MOST LIKELY BELOW 10 PERCENT, ALTHOUGH PROBABLY NOT SO STRINGENT AS THE ORIGINAL COMMISSION PROPOSAL. THE DIFFERENCE ON CENTRAL GOVERNMENT EXPENDITURE, WHILE SMALLER, MAY PROVE TO BE SOMEWHAT MORE DIFFICULT TO RESOLVE, SINCE ITALIAN RESISTANCE IS SAID TO BE VERY STRONG IN THIS AREA. NEVERTHELESS, OPTIMISM IS PROFESSED THAT A SATISFACTORY PACKAGE CAN BE AGREED TO.

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5. REF B NOTED THAT ITALIAN AUTHORITIES EXPECT COMPLIANCE WITH THE 1976 EC GUIDELINES ON THE TREASURY BUDGET DEFICIT (ALTHOUGH COMMISSION EXPERTS EXPRESS SOME DOUBT), A MODERATE EXCESS OVER THE CEILING ON TOTAL CENTRAL GOVERNMENT EXPENDITURE, AND SUBSTANTIAL EXCESSES OVER LIMITS ON THE FINANCING OF THE DEFICIT BY THE MONETARY AUTHORITIES AND ON GROWTH IN TOTAL DOMESTIC LENDING. OFFICIALS HERE HAVE MIXED REACTIONS. ONE SUGGESTS EVEN THIS PARTIAL SUCCESS MEANS THAT 1976 GUIDELINES WERE TOO LAX, GIVEN THE INFLATIONARY EXPANSION OF THE ECONOMY LAST YEAR. ANOTHER ARGUES THAT HAD THOSE GUIDELINES BEEN STRICTLY OBSERVED, AND ON A MORE EVEN BASIS THROUGHOUT THE YEAR, ITALY WOULD HAVE BEEN SPARED MUCH OF THE INFLATION AND BALANCE OF PAYMENT PROBLEMS SHE SUFFERED IN 1976.

6. THE COMMISSION CONTINUES TO PLACE GREAT EMPHASIS ON THE NEED FOR SIGNIFICANT MODIFICATION OF WAGE-INDEXING ARRANGEMENTS IN ITALY. THERE IS A WIDE RANGE OF VIEWS ON WHETHER A SATISFACTORY RESOLUTION OF THIS PROBLEM CAN BE REACHED IN THE CURRENT ITALIAN

POLITICAL CONTEXT, BUT ALL AGREE THAT SOME EFFECTIVE MEASURES TO SLOW DOWN LABOR COST INCREASES MUST BE IMPLEMENTED IF THE STABILIZATION PROGRAM IS TO SUCCEED.

7. THE DELAY IN REACHING AGREEMENT IN ITALY ON THIS KEY POLICY ISSUE IS GIVEN AS THE PRINCIPAL REASON (TOGETHER WITH ITALY'S IMPROVED FOREIGN EXCHANGE RESERVE POSITION) WHY A FINAL COMMITMENT ON THE PROPOSED COMMUNITY LOAN HAS BEEN POSTPONED. THE DESIRE TO HARMONIZE CONDITIONS WITH THE IMF IS GIVEN AS A SECONDARY REASON, SINCE IT IS FELT THAT ENOUGH IS KNOWN OF IMF VIEWS ON NEEDED POLICY MEASURES TO ASSUME COMPATIBILITY OF CONDITIONS. NEVERTHELESS, ONE LESS-CAUTIOUS SOURCE SUGGESTS THAT THE GERMANS MAY DELAY FINAL AGREEMENT ON THE COMMUNITY LOAN UNTIL AN IMF DRAWING IS ALSO LINED UP. IN ANY CASE, DIRECTOR-GENERAL MOSCA (DG-II) SAYS HE EXPECTS AGREEMENT TO BE REACHED ON CONDITIONS AND FINAL APPROVAL TO BE GIVEN EITHER AT THE JANUARY 17 FINANCE COUNCIL, OR, AT THE LATEST, AT THE CONFIDENTIAL

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FEBRUARY FINANCE COUNCIL. HINTON

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